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# BUYING A FRANCHISE

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**Buying a franchise involves the purchase of the right to operate a business according to a set plan or system that has been established by a franchising company. The product or service being marketed is identified by a trademark held by the franchising company and the company maintains some measure of control to ensure uniformity of practices and services throughout all the franchise outlets.**

For many companies, setting up a network of franchise operations is the ideal marketing method. The company requires relatively little capital for expansion because it is financed through the sale of franchises. The franchise owner becomes responsible for his own sales and his own survival.

Before committing time and money to such an operation, therefore, the potential franchise buyer should ask himself some basic questions about the franchising company, its product(s) and the franchise agreement that he is asked to sign.

## **"How good is the company?"**

If the company offering you a franchise is second-rate, or is not concerned about the profitability of its franchises, your own efforts will be wasted. You should be looking for a sound company with market potential.

Find out how long the company has been in business and how long the present management has been with the company.

You should be looking for a stable company that has attracted and will continue to attract competent businessmen who intend to stay with the firm.

In some cases, franchise outlets will be offered by new companies that are just entering the market with a new product or selling idea. Such ventures obviously entail a much higher degree of risk than would be the case with a well-established business enterprise. You should insist, therefore, that the following two conditions are met in addition to those precautions outlined for regular franchise agreements.

First, there should be at least one outlet already operative that you can visit in order to study and evaluate the product, the marketing techniques and the overall effectiveness of the operation.

Secondly, you must insist that the company hold your franchise deposit in trust or escrow until your franchise outlet is open and operating. (In fact, it is a good idea to include this trust money provision in any franchise agreement that involves opening a new outlet.)

How innovative is the company?

Retailing is a fast-changing business requiring new ideas and fresh approaches. Find out if the company is thinking about or exploring new products, services, or sales methods.

Investigate the company's reputation in the business community. Your bank or credit agency, the Better Business Bureau, the provincial Ministry of Consumer and Commercial Relations, or the Chamber of Commerce will be able to help you here.

Also check the company's reputation with its franchise owners. Ask people who are already in the business what they think about the company.

Take the franchise agreement to a lawyer and to an accountant. This professional advice costs less than you probably think, especially considering the money you could lose by signing the wrong agreement. If you have any doubts about how much it will cost, remember that it is standard practice to inquire about such fees in advance. No company worth joining will have any argument with your seeking independent advice.



Ask to see the company's financial records. Make sure they have been signed by a Chartered Accountant. That way you know they have been audited and found to be correct.

Find out how the company makes its money. It should be making money because its franchises are doing well, not because it is constantly selling new franchises or reselling existing ones. It should be product sales conscious.

If you are asked to take over an existing franchise find out why the previous franchisee left. Get both sides of the story.

### **"How good is the product and the market for it?"**

Selling the product or service is the only way you will make money. You should find out the following information about the product and the place where you are going to sell it.

Is the product available now or is it only in the planning stage?

If the product is "still under development" be extremely cautious about advancing any funds unless the company agrees to hold your money in trust until the product is available. The company may even be able to show you prototypes, or sample models, but this does not mean that the product is available for general distribution.

Conversely, consider the length of time an established product has been on the market. Is it likely to be replaced by something more up to date or easier to handle?

Beware of fad products or those that are highly seasonal in nature. Remember you will still have bills to pay when the fad or season is over. Demand for luxury items may also be unreliable.

Can you buy similar products at other outlets in your prospective sales territory? Competition is a good thing but a saturated market could ruin your chances of business success.

Check the price of your product against that of the competition. Maybe you have the right product, but the wrong price. You might even be better off to join your potential competitor.

Does your franchisor manufacture the product or just distribute it? If the company is just the distributor, there is a danger you could be cut off or undersold. What guarantee does your company give that it will be able to continue getting the product for you at a good price?

A good product has a manufacturer's guarantee. Does yours? If you sell something you wouldn't buy yourself, you probably won't sell it well.

Does your market size fluctuate seasonally? Is the population in the area rising or falling?

Check with local municipal officials about by-laws in your market area that might affect your franchise. Ask if there are any plans for changes in traffic patterns or redevelopment which could seriously affect the business in your proposed location.

Always confirm from independent sources any claims by the franchisor that getting a licence or permit will be no problem. Even if they are sincere, they may be very wrong. Such a mistake could ruin you. Find out for yourself by contacting the appropriate government officials.

Depending upon the product that you are planning to sell, information may also be available from provincial and federal government plans and statistics that can help you to understand the general market environment and trends.

### **"What does the company offer you?"**

No good company will just leave you on your own. They should be prepared to offer you assistance with the following.

*A good location.* Check carefully to see if your location is guaranteed and the territory protected from entry by other franchises from the same company. Is your territory clearly defined?

*A training program.* This should be provided for both you and your employees. Ask for a detailed description in writing of the training you are promised.

*Professional services.* Be certain in advance exactly what continuing assistance in the way of managerial advice, accounting and advertising will be made available to you. Find out how much these will cost you.

*Placing your deposit in trust.* Does the company plan to place your deposit for purchase of the franchise in a trust or in escrow until the day your outlet actually opens? You are taking a tremendous risk of losing your money if it doesn't.

*A means for resolving conflicts.* You should find out how the company has resolved its differences with its franchise owners in the past. Check the franchise agreement to see if there is a clause covering this. Many unfortunate franchisees have discovered that disputes are settled by the company simply terminating the franchise agreement.

The best way to ensure that these basic conditions are included in the agreement is to consult with a lawyer of your choice.



## **"What will the franchise cost you?"**

There are many hidden costs in running a franchise. Here are some of the matters you should investigate.

Find out exactly what you are getting in return for your franchise fee.

Check the interest rate against that charged by other financial institutions.

What is your guarantee that the company will provide prompt delivery of the product or supplies? Is there a penalty for delay?

Are you obligated to buy supplies and equipment from companies specified by the franchisor? It may end up costing you much more than if you could choose your supplies independently.

What are the continuing financial obligations you have to the company? There may be royalties, advertising fees, mandatory supply purchases, accounting fees, or charges for other services. You should check to see if the company can arbitrarily change any of the prices for these.

Don't simply accept the company's estimate of earnings without doing your own investigation and calculations. If the company gives you an example of earnings, check it against your location, size of market, business hours as well as other overhead and seasonal factors. Is the example you are given really comparable to the situation in your franchise territory?

What is the total amount you will need to join the franchise? Include everything in this total cost — even a provision for the value of your time and labour. You certainly won't help yourself by underestimating costs.

What do you receive for the total amount you will pay out?

If your franchise is not as immediately successful as you have estimated, will you be able to raise additional money to remain in business? Committing everything you have at the beginning is a very risky way of doing business.

Is there a franchise renewal fee?

## **"Do you understand how your agreement can be terminated?"**

What are the conditions under which the franchisor can terminate your agreement? Perhaps you are an independent-minded person who likes to run his own show, make his own decisions. Deviating from the established course set up by the franchisor could result in your losing the franchise.

Is there a provision for repurchase of equipment and inventories? What formula will be used to determine the price?

Do you have the right to sell the franchise? Check the conditions for resale carefully.

In the case of death, will your family be permitted to continue operation of the franchise? Under what conditions?

## **"Where is more information available?"**

There are many good books on franchising. Try your local public library. Or you can write to:

Franchising,  
The Ministry of Consumer &  
Commercial Relations,  
555 Yonge Street,  
Toronto, Ontario.

### ***TERMS:***

**Franchisor:** The company offering a franchise for sale.

**Franchisee:** The individual or group purchasing a franchise.



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